

Office of Chief Counsel  
Internal Revenue Service  
**Memorandum**

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to: Director, Tax Exempt Bonds  
(Tax Exempt & Government Entities)

from: Associate Chief Counsel  
(Financial Institutions & Products)

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subject: Tribal Economic Development Bonds Under § 7871(f) and Build America Bonds  
under § 54AA

This memorandum addresses the interaction between tribal economic development bonds under § 7871(f) of the Internal Revenue Code ("Tribal Economic Development Bonds") and build America bonds under § 54AA ("Build America Bonds"). This memorandum should not be used or cited as precedent.

ISSUE

Can an Indian tribal government that has received an allocation of volume cap pursuant to § 7871(f)(1) of the Internal Revenue Code (the "Code") to issue Tribal Economic Development Bonds elect under § 54AA(d)(1)(C) to issue those bonds as Build America Bonds instead of issuing the bonds as tax-exempt bonds under § 103?

CONCLUSION

An Indian tribal government that has received an allocation of volume cap pursuant to § 7871(f)(1) to issue Tribal Economic Development Bonds can elect under § 54AA(d)(1)(C) to issue such bonds as Build America Bonds instead of issuing the bonds as tax-exempt bonds under § 103.

## FACTS

An Indian tribal government (the “Tribe”) applied for and received an allocation under § 7871(f)(1) to issue Tribal Economic Development Bonds. The Tribe intends, pursuant to such allocation, to issue bonds (the “Bonds”) and to designate the Bonds as Tribal Economic Development Bonds. Interest on the Bonds would be exempt from tax under § 103 if issued by a State or local government. The amount of the Bonds would not exceed the amount of the allocation received. Proceeds of the Bonds will not be used for (1) any portion of a building in which class II or class III gaming (as defined in section 4 of the Indian Gaming Regulatory Act) is conducted or housed or any other property actually used in the conduct of such gaming or (2) any facility located outside the Tribe’s reservation (as defined in § 168(j)(6)).

The Bonds will otherwise satisfy all of the relevant requirements under § 103 to be treated as tax-exempt bonds. The Tribe would like to elect to issue the Bonds as Build America Bonds under § 54AA instead of tax-exempt bonds under § 103. The Bonds will satisfy all the applicable requirements for issuance as Build America Bonds under § 54AA, including, among other things, the requirement that the bonds not be private activity bonds within the meaning of § 141 and that the bonds be issued prior to January 1, 2011.

## LAW AND ANALYSIS

Section 103(a) provides that except as provided in § 103(b), gross income does not include interest on any State or local bonds. Section 103(b) provides that § 103(a) does not apply to any private activity bond which is not a qualified bond, any arbitrage bond and any bond which does not meet the applicable requirements of § 149. Section 103(c)(1) defines the term “State or local bond” as an obligation of a State or political subdivision thereof. Section 103(c)(2) defines the term State to include the District of Columbia and any possession of the United States.

Section 7871(a)(4) provides that, subject to § 7871(c), an Indian tribal government is to be treated as a State for purposes of § 103 (relating to State and local bonds). Section 7871(c)(1) provides generally that, except for obligations for certain manufacturing facilities described in § 7871(c)(3), § 103(a) shall apply to any obligation issued by an Indian tribal government (or subdivision thereof) only if such obligation is part of an issue substantially all of the proceeds of which are to be used in the exercise of any essential governmental function. Section 7871(e) provides that for purposes of § 7871 the term “essential governmental function” shall not include any function which is not customarily performed by State and local governments with general taxing power.

Section 1402 of Title I of Division B of the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2009) (the “Act”), added new § 7871(f) to the Code providing for the authority to issue Tribal Economic Development Bonds.

Section 7871(f)(1) provides that the Treasury Department shall allocate the \$2 billion national volume cap for Tribal Economic Development Bonds among the Indian tribal governments in such manner as the Treasury Department, in consultation with the Secretary of the Interior, determines appropriate. Section 7871(f)(2)(A) provides that, notwithstanding the provisions of § 7871(c), Tribal Economic Development Bonds are treated for purposes of the Code as if they were issued by a State. Sections 7871(f)(2)(B) and (C) provide that an Indian tribal government issuing a Tribal Economic Development Bond shall be treated as a State for purposes of § 141 and that the volume cap requirement of § 146 does not apply.

Section 7871(f)(3)(A) defines a Tribal Economic Development Bond generally to mean any bond issued by an Indian tribal government the interest on which would be exempt from tax under § 103 if issued by a State or local government, and which is designated by the Indian tribal government as a Tribal Economic Development Bond for purposes of § 7871(f).

Section 7871(f)(3)(B) further provides that the term Tribal Economic Development Bond shall not include any bond issued as part of an issue if any portion of the proceeds of such issue are used to finance: (1) any portion of a building in which class II or class III gaming (as defined in section 4 of the Indian Gaming Regulatory Act) is conducted or housed or any other property actually used in the conduct of such gaming, or (2) any facility located outside the Indian reservation (as defined in § 168(j)(6)).

Section 7871(f)(3)(C) provides that the maximum aggregate face amount of bonds which may be designated by any Indian tribal government under § 7871(f)(3)(A) may not exceed the amount of national Tribal Economic Development Bond volume cap allocated to such Indian tribal government under § 7871(f)(1).

Section 1531 of Division B of the Act added new § 54AA to the Code providing the authority to issue Build America Bonds. Section 54AA(d)(1) provides that the term Build America Bond means any obligation (other than a private activity bond) if: (i) the interest on such obligation would (but for § 54AA) be excludable from gross income under § 103, (ii) such obligation is issued before January 1, 2011, and (iii) the issuer makes an irrevocable election to have § 54AA apply. Pursuant to §§ 54AA(a) and (b), holders of Build America Bonds may claim a tax credit equal to 35 percent of the amount of interest payable on an interest payment date. Under § 54AA(g)(1), in lieu of the holder of a Build America Bond receiving a tax credit, the issuer of a qualified Build America Bond can elect to receive the payment from the federal government as provided in § 6431.

Section 6431(a) provides that in the case of a qualified bond, the issuer of such bond shall be allowed a credit with respect to each interest payment under such bond. Section 6431(b) provides that the Treasury Department shall pay (contemporaneously with each interest payment date under such bond) to the issuer of such bond (or to any

person who makes such interest payments on behalf of the issuer) 35 percent of the interest payable on such bond on such date. Section 6431(e) provides that the term “qualified bond” has the meaning given such term in § 54AA(g). Section 54AA(g)(2) provides that the term “qualified bond” means any Build America Bond issued as part of an issue if the excess of the available project proceeds of such bond issue over the amounts in a reasonably required reserve fund are to be used for capital expenditures, and the issuer makes an irrevocable election to have § 54AA(g) apply to such bond.

Based upon the facts presented, the Bonds would qualify as Tribal Economic Development Bonds within the meaning of § 7871(f)(3). As such, the Bonds are obligations that would be excludable from gross income under § 103 if issued as tax-exempt obligations and therefore satisfy the requirement for Build America Bonds provided in § 54AA(d)(1)(A). In addition, the Bonds will not be private activity bonds within the meaning of § 141 and will be issued before January 1, 2011, in accordance with the requirements of § 54AA(d). Accordingly, the Bonds meet the requirements under § 54AA(d) to qualify as Build America Bonds, provided the Tribe makes the irrevocable election required by that section. The requirement that the Tribe designate the Bonds as Tribal Economic Development Bonds does not prevent the Tribe from also making the election pursuant to § 54AA(d)(1)(C) to treat the Bonds as Build America Bonds. The volume cap allocated to the Tribe for the issuance of designated Tribal Economic Development Bonds will be utilized upon the issuance of the Bonds as Build America Bonds.

In addition, provided that the Tribe satisfies the applicable requirements of § 54AA(g) and § 6431, the Tribe may elect to receive the refundable credit under § 6431 in lieu of holders receiving tax credits with respect to such Bonds.

Please call Timothy Jones or Aviva Roth at (202) 622-3980 if you have any further questions.